Supreme Court, U.S.
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No. 06-267

In the Supreme Court of the United States

GOVERNMENT OF TURKMENISTAN,

Petitioner,

v.

BRIDAS S.A.P.I.C., BRIDAS ENERGY INTERNATIONAL, LTD., INTERCONTINENTAL OIL & GAS VENTURES, LTD., AND BRIDAS CORP.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

Respondents offer no valid reason why this Court should not review the questions presented.

I. The Fifth Circuit's Expansion Of The Scope Of The *Bancec* "Injustice" Exception Conflicts With *Bancec* And With Decisions Of Other Circuits.

In *Bancec*, this Court crafted a narrow "injustice" exception to the presumption that a state instrumentality is independent of the state that established it. The Fifth Circuit greatly expanded the scope of that exception by finding it applicable based merely on an instrumentality's potential inability to fulfill its contractual obligation to pay an arbitration award. As the petition demonstrates (at 10-13), other courts of appeals consistently have refused to expand the scope of the *Bancec* "injustice" exception to reach mere contract breaches or other commercial harms. This Court should grant review to resolve that conflict and to ensure that U.S. courts show "[d]ue respect for the actions taken by foreign sovereigns and for principles of comity between nations." *Bancec*, 462 U.S. at 626. Such respect requires giving effect to the structures set up by foreign sovereigns to shield them from commercial claims properly directed to their commercial instrumentalities.

Bridas does not deny that the scope of the *Bancec* "injustice" exception presents an important federal question, nor does it identify any reason why this case does not present an effective vehicle for resolving it. Instead, Bridas responds (Br. 8-9) that *Bancec* sets forth an additional "control" exception that provides an independent basis for the Fifth Circuit's alter ego ruling. But as the Court in *Bancec* expressly stated, consistent with its deference to "principles of comity," that exception applies only "where a corporate entity is so extensively controlled by its owner that a relationship of *principal and agent* is created." 462 U.S. at 629 (emphasis

added). As the petition notes (at 17-18), the Fifth Circuit in *Bridas I*, 345 F.3d at 357-358, *rejected* Bridas's contention that the relationship between the Government and Turkmenneft is one of principal and agent, a ruling never challenged by Bridas. Hence, the "injustice" exception offers the only basis on which the *Bancec* presumption of independence may be overcome.

Bridas correctly states (Br. 9) that *Bancec* does not establish a "mechanical formula" for determining the requisite "injustice." But the lack of a mechanical formula does not mean the absence of a legal standard. The Government maintains that the Fifth Circuit should have adhered to the comity-based framework established by *Bancec* for determining whether the presumptive independence of state enterprises may be disregarded. The outcome in *Bancec* was consistent with that comity framework because disregarding the separate identity of the instrumentality prevented the state from ignoring that identity in asserting its claim while relying on it to avoid setoff for the government's unlawful expropriation and did not intrude into the state's internal affairs or treasury. In contrast, retroactively binding a foreign government to its instrumentality's arbitration agreement flou[illegible] comity by disregarding "the efforts of sovereign nations to structure their governmental activities in a manner deemed necessary to promote economic development and efficient administration." *Bancec*, 462 U.S. at 626.[1]

Bridas cites not a single court of appeals decision (other than the ruling below) that expands the scope of the *Bancec* injustice exception to reach mere commercial harms or otherwise finds the "injustice" exception satisfied. In contrast,

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[1] Justice Stevens, too, concurring in part and dissenting in part in *Bancec*, rejected "the contention that American courts should readily 'pierce the corporate veils' of separate juridical entities established by foreign governments to perform governmental functions." 462 U.S. at 634.

the petition cites numerous cases (at 10-14) where courts of appeals refused to find the injustice exception applicable without an attempt to use U.S. courts both as a sword to impose liability and as a shield from liability for violations of international law. The Second Circuit, for example, rejected the applicability of the injustice exception in *Zappia*, 215 F.3d at 252, where the alleged government wrong was a mere breach of contract, and in *Chemical Bank*, 782 F.2d at 380, where the government was not using domestic courts as both a sword and a shield. See Pet. 10-11. Bridas offers no meaningful reason why a different analysis should apply in this case or a different result should be reached.

Contrary to Bridas (Br. 10), the fact that the courts in the cases cited in the petition (at 10-14) considered and rejected a variety of proffered reasons to override the presumption of independence supports the Government's showing that the Fifth Circuit's expansive view of the injustice exception conflicts with the narrow view accepted by other circuits.

Bridas argues (Br. 11-12) that Turkmenneft's supposed undercapitalization and the deposit of its revenues in a state fund make the award against it uncollectible and justify the Fifth Circuit's disregard of its juridically separate status. But nothing in *Bancec* suggests that the presumption of an instrumentality's independence rests on the amount of its capital or where its revenues are deposited. If those were the relevant factors, the presumption of independence would be weak indeed. Even for private corporations, stated capital or par value is generally far less than the value of an entity's actual capital. See PINTO & BRANSON, UNDERSTANDING CORPORATE LAW § 4.04 (2d ed. 2004). Bridas does not dispute the petition's showing (at 22) that Turkmenneft continues to receive abundant revenues and possesses

abundant assets, nor has it shown that those revenues or assets cannot be used to satisfy an arbitration award.[2]

Nor does Bridas attempt to show how the potential uncollectibility of its award against Turkmenneft fits within the *Bancec* "injustice" framework. As the Eleventh Circuit has explained, such uncollectibility "is present in every case in which a plaintiff seeks to hold an instrumentality responsible for the debts of its related government." *Alejandre*, 183 F.3d at 1286-1287 & n.22. Bridas's suggestion (Br. 12) that the rejection of such uncollectibility arguments in *Alejandre* and *Flatow* rested on the governments' sovereign immunity is simply wrong. The Eleventh Circuit's ruling in *Alejandre* was based on the "presumptively separate juridical status" of the state enterprise at issue (183 F.3d at 1286), and the court expressly stated that uncollectibility "is not the type of injustice that concerned the *Bancec* Court" (*id.* at 1286 n.22). The Ninth Circuit's ruling in *Flatow* also was based on its deeming the bank at issue "a separate juridical entity under *Bancec*," and the court rejected the contention that ownership of an Iranian bank's capital by the Iranian government rebutted the bank's presumption of independence. 308 F.3d at 1073.

In light of Bridas's failure to pursue collection on its award against Turkmenneft or to enforce the Government's separate contractual guaranty (see *Bridas I*, 345 F.3d at 357; Pet. 2), its speculation that the award *might* be uncollectible (Br. 13 n.2) hardly demonstrates the manifest injustice required by *Bancec* and its progeny. "Allowing the *Bancec* presumption of separate juridical status to be so easily

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[2] Even if proceeds from Turkmenneft's sale of oil and gas were paid to a governmental fund immune from seizure, as the Fifth Circuit found (Pet. App. 8a, 13a), neither the Fifth Circuit nor the district court found that Turkmenneft lacked the ability or authority to pay an arbitral award as an above-the-line cost before sending net sales proceeds to the fund.

overcome would effectively render it a nullity." *Alejandre*, 183 F.3d at 1287. Indeed, it has been long established that a confirmation proceeding is not the proper vehicle for piercing the corporate veil based on uncollectibility, especially where the proponent may pursue an enforcement action against the other contracting party or a separate action against a guarantor. See *Orion Shipping & Trading Co.* v. *Eastern States Petroleum Corp.*, 312 F.2d 299, 301 (2d Cir. 1963). Bridas chose to forgo those options here.

Finally, Bridas contends (Br. 16-17) that overriding the presumptive independence of state instrumentalities in this fashion will promote economic development by upholding "traditional legal doctrines." But as this Court explained at length in *Bancec*, 462 U.S. at 625-626, that presumption of independence enables "developing countries [to] obtain the financial resources needed to make large-scale national investments." See Pet. 7-8. For that reason, the Court established the legal doctrine that governs this case—"duly created instrumentalities of a foreign state are to be accorded a presumption of independent status." 462 U.S. at 626-627. Bridas's reliance on other doctrines, "traditional" or otherwise, to overcome that presumption flouts this Court's controlling doctrine, as well as the principles of comity on which it is grounded.

II. The Fifth Circuit Should Not Have Bound The Government To Turkmenneft's Arbitration Agreement Based On The Alter Ego Doctrine.

Bridas nowhere denies that it agreed to structure its transaction so that only claims against Turkmenneft would be arbitrated, or that it retained the right to pursue any claims against the Government in court. It offers no reason why, even if all its complaints against the Government were valid, a court should restructure that transaction to impose an obligation to arbitrate on the Government, much less why a court should do so long after the arbitration took place. Parties

that contract with government instrumentalities cannot plausibly disclaim knowledge at the time of contracting that such instrumentalities have significant ties to the governments that established them.

It is no answer to say, as Bridas does (Br. 14), that a nonsignatory "may be bound to an arbitration agreement under various legal theories." That of course is true. But the Fifth Circuit rejected all such theories other than alter ego (see *Bridas I*, 345 F.3d at 356-363), and Bridas cites not a single case where a court bound a nonsignatory to arbitrate based on the alter ego doctrine. To be sure, alter ego might justify binding a nonsignatory to arbitrate where there was a misuse of the corporate form *at the time of contracting*. In those circumstances, fraud at the onset might well have affected the parties' forum allocation agreements. But it makes no sense to undo forum allocation agreements made with full information at the time of contracting based on events that take place years later. To do so, as the Fifth Circuit did here, flies in the face of the consensual basis of arbitration.

The Government does not seek to privilege arbitration agreements over contracts in general, as Bridas contends (Br. 15). We know of no general contract principle (and Bridas cites none) that would allow a court to override forum allocation agreements based on later conduct totally unrelated to the proper forum for resolving the parties' disputes. Absent "fraud, undue influence, or overweening bargaining power" at the time of contracting, the place to resolve the substance of such disputes is in the forum (or fora) selected by the parties. *M/S Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1, 12-13 (1972). Here, the parties knowingly agreed that only disputes between Bridas and Turkmenneft would be resolved in an arbitral forum. Giving effect to that agreement would not require Bridas to forfeit its claims against the Government because it remains free to pursue such claims in court. The Fifth Circuit's retroactive overthrow of the parties' forum

allocation agreement is inconsistent with the consensual basis both of arbitration and of contract law.

Finally, Bridas contends (Br. 16) that this is a "rare case" in which the Court's review is "not warranted" because "nonsignatories are so infrequently bound by agreements they did not sign." But the infrequency of a particular result should not deter review where, as here, the underlying issue arises frequently. The multiple cases cited in the petition (at 10-14) that have wrestled with the *Bancec* presumption and its "injustice" exception show that the scope of the injustice exception is a recurring and important issue of federal law on which the lower courts require guidance.

III. The Fifth Circuit's Ruling Rested On Improper *De Novo* Fact-Finding.

The Fifth Circuit's refusal to recognize the Government's independence from Turkmenneft rested entirely on its finding of uncollectibility. Having rejected the notion that Turkmenneft was the Government's agent, and having found that Bridas was not defrauded into the Keimir transaction, the court of appeals could justify its ruling only by finding the requisite "injustice." The only injustice it posited was the establishment of Turkmenneft as the Turkmenian Party so as to prevent Bridas from collecting on its award against Turkmenneft. As the petition explains (at 22), the district court made no such uncollectibility finding, making the Fifth Circuit's finding of this critical "fact" *de novo*.

Bridas responds (Br. 17-18) that such appellate fact-finding is perfectly acceptable so long as the court of appeals does not "disturb" or "contradict" any of the district court's findings. It offers no authority for that proposition, which conflicts with the established principle that courts of appeals are not to make factual findings on disputed factual issues not resolved by the district court. See Pet. 23. Bridas cites three cases, but none supports its view. In *Sampson*, this Court did not resolve a disputed fact issue on appeal; it "examin[ed] the

record to determine if *sufficient* allegations or *sufficient* evidence supports the issuance of injunctive relief" granted by the district court. 415 U.S. at 86 n.58 (emphasis added). In *In re Holloway*, 955 F.2d at 1015, and *Magna Weld Sales Co.*, 545 F.2d at 671-672, the courts simply made factual inferences based on undisputed supporting facts. At bottom, Bridas's position makes no sense as a matter of appellate practice; if appellate courts were permitted to engage in *de novo* fact-finding, there would be virtually no possibility of correcting their clearly erroneous findings and parties would be denied meaningful judicial review.

Bridas further contends (Br. 18) that the court of appeals merely "affirmed" the district court's finding that Turkmenneft lacked financial independence from the Government. But uncollectibility does not follow inexorably from the financial interdependence of states and state enterprises. If that were the case, the *Bancec* presumption would be meaningless because it is typical for the state to "provide capital" to and "cover losses" by the instrumentality. *Bancec*, 462 U.S. at 624. Although Bridas asserts (Br. 19) that the Fifth Circuit had a sufficient record on which to make an uncollectibility finding, it points to *nothing* in the record indicating an attempt to pursue collection on the Turkmenneft award, making the Fifth Circuit's factfinding unsupported (as well as unauthorized and unripe). Indeed, the Fifth Circuit's finding that the Government prevented Bridas from realizing the benefits of the contract (Pet. App. 8a) cannot be reconciled with Bridas's ability to pursue collection directly against the Government through an action on the guaranty.

IV. This Court Should Resolve The Conflict In The Lower Courts Over The Manifest Disregard Of Law Standard For Vacating Arbitration Awards.

Bridas contends (Br. 20) that review is unwarranted on the manifest disregard issue because Turkmenneft's prior petition raising this issue was denied. It disregards the fact that what

was then an interlocutory ruling is now a final judgment. Moreover, the Government was not a party to the earlier petition, as Bridas inaccurately states (*ibid.*); that petition was filed by Turkmenneft alone. Bridas's further contention (Br. 23) that Rule 14.2 bars cross-references to other petitions also is incorrect. Rule 14.2 bars separate briefs in support of a petition but says nothing about cross-referencing petitions, and this Court has never suggested that it does. In fact, by avoiding needless repetition of the arguments already set forth in Turkmenneft's petition, the Government has complied with the admonition in Rule 14.3 that the grounds for certiorari "should be stated briefly."

Bridas's assertion (Br. 20) that no conflict exists on the manifest disregard standard is easily refuted by comparing *Patten* v. *Signator Ins. Agency, Inc.*, 441 F.3d 230 (4th Cir. 2006), cert. denied, No. 06-49 (Oct. 16, 2006), with *George Watts & Son* v. *Tiffany & Co.*, 248 F.3d 577 (7th Cir. 2001). Whereas the Fourth Circuit will vacate an award for manifest disregard of the law where "the arbitrator understands and correctly states the law, but proceeds to disregard the same" (441 F.3d at 235), the Seventh Circuit requires that the arbitrator "direct the parties to violate the law" before it will vacate an award on that basis (248 F.3d at 580).

Such conflicts over the manifest disregard standard warrant review and resolution by this Court. The Court twice has referenced the manifest disregard of the law standard in dicta but never has articulated its meaning and scope. See *First Options, Inc.* v. *Kaplan*, 514 U.S. 938, 942 (1995); *Wilko* v. *Swan*, 346 U.S. 427, 436-437 (1953), overruled on other grounds, *Rodriguez de Quijas* v. *Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989). This case presents an appropriate vehicle to do so.

Finally, Bridas contends (Br. 22) that this issue is "not justiciable" because in *Bridas I* the Government identified "no controlling law" that the arbitrators could have

disregarded. That is not so. The Government conditionally joined in Turkmenneft's motion to vacate the award in the district court, and on appeal it expressly incorporated Turkmenneft's manifest disregard argument, which identified English law as the controlling law pursuant to the Joint Venture Agreement. See Turkmenneft Opening Br. 30-32 (Nov. 4, 2002); Gov't Opening Br. 43 (Nov. 4, 2002). In particular, the Government and Turkmenneft contended that English law limits breach of contract damages to actual damages and that the arbitrators manifestly disregarded that principle by employing an objectively unreasonable discount rate resulting in an award that exceeded actual damages by some $200 million. Whether the arbitrators disregarded controlling law in that respect presents a legal issue, not, as Bridas asserts (Br. 22), a "factual issue." The Government requests review to resolve the conflict and uncertainty over the proper standard governing that legal issue.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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